

OFFICIAL FILE
ILLINOIS COMMERCE COMMISSION



Terry L. Gloriod
President
Central Region

November 21, 2005

Illinois Commerce Commission
527 E. Capitol Avenue
Springfield, IL 62701

RE: Docket No. 01-0832

- Report

Attention: Elizabeth Rolando,
Chief Clerk of the Commission

Dear Ms. Rolando:

We are providing a November 7, 2005 report from Standard and Poor's related to the rating for American Water Capital Corp.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Terry L. Gloriod".

ILLINOIS AMERICAN WATER
Terry L. Gloriod,
President

CHIEF CLERK'S OFFICE

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ILLINOIS
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Research:

Research Update: American Water Capital Ratings Are Lowered To 'A-', On Watch Neg Re: Sale By Parent

Publication date:

07-Nov-2005

Primary Credit Analyst:

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kevin_beicke@standardandpoors.com

Credit Rating: A-Match Neg/NR

■ Rationale

On Nov. 7, 2005, Standard & Poor's Ratings Services lowered its corporate credit rating on American Water Capital Corp. (AWCC) to 'A-' from 'A' and placed the ratings on Creditwatch with negative implications. In addition, AWCC's senior unsecured ratings were lowered to 'BBB+' from 'A-'.

AWCC is a wholly owned subsidiary of American Water and serves as the funding vehicle for American Water's regulated water utility subsidiaries. American Water is a wholly owned subsidiary of parent RWE AG (A+/Negative/A-1).

The rating action follows the announcement made by RWE of its intention to sell its U.K. and U.S. water businesses and reflects the weaker, stand-alone credit quality of AWCC, absent RWE's support. Standard & Poor's will meet with American Water's management to discuss in detail the effect of this announcement, especially in relation to the future strategic direction, financial policy, capital structure, liquidity, and funding of the company. The Creditwatch listing on AWCC is not expected to be resolved until the completion of the sale, due to the greater amount of uncertainty regarding the future plans for the American Water operations versus those of the U.K. water business, RWE Thames Water PLC (A/Watch Neg/A-1).

RWE's decision is driven by its desire to focus on electricity and gas operations in Europe. The sale process will start with the U.S. Water Operations. Once this transaction is well underway, it will continue with RWE Thames Water. The process will be lengthy, as it requires the approval of RWE's supervisory board and regulatory approvals. The goal is to complete both transactions during 2007.

American Water's stand-alone credit quality is supported by its '2' (excellent) business profile. (Utility business profiles are categorized from '1' (excellent) to '10' (vulnerable).) The company's business profile benefits from geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are only slightly offset by American Water's nonregulated water and wastewater operations. American Water is also hampered by a weak, but improving, financial risk profile.

American Water's excellent business risk profile is partly countered by the company's intermediate, stand-alone financial risk profile, which is weak for the rating. Debt leverage has improved dramatically since the merger with RWE, dropping to 48% from 69.1% at year-end 2002, due to RWE's \$3 billion infusion of preferred stock and common equity in 2003. For year-ended Dec. 31, 2004, adjusted funds from operations (FFO) to average total debt was just 12.5%, which is low, but a significant improvement from 7.5% in fiscal 2003. Adjusted FFO interest coverage and adjusted EBIT interest coverage have also improved over the past year, to 3.7x and 2.2x, respectively. The company's ROE was a mere 1.2% in 2004, but is expected to improve this year due to the full realization of rate increases in many of the company's service areas.

Liquidity

AWCC's liquidity position is adequate. American Water has received previous support from RWE in the form of intercompany loans, but this support will lessen going forward. Leading up to the completion of the sale of RWE's U.S. water operations, it is expected that American Water will gradually need to start sourcing its own funding. However, Standard & Poor's expects RWE's continued, although diminished, support to American Water before the completion of the sale to

alleviate any near-term liquidity constraints.

Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. American Water has \$1,219.9 million of long-term debt maturing in 2006, nearly all of which is in the form of RWE intercompany loans.

As of March 31, 2005, American Water had \$41.7 million in cash and cash equivalents. AWCC also has a \$550 million, 364-day revolving credit agreement with RWE. AWCC had \$239.9 million in availability from these credit lines as of Dec. 31, 2004. Borrowing under the credit agreement is based on LIBOR, and AWCC pays a commitment fee of 6.575 basis points on the entire amount. For 2004, the weighted-average interest rate on the outstanding lines was 1.43%.

■ Ratings List

Ratings Lowered, Placed On Watch Neg

American Water Capital Corp,

	To	From
Corp. credit rating	A-/Watch Neg/--	A/Negative/--
senior unsecured rating	BBB+/Watch Neg	A-

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

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